

SOUTH COAST AIR QUALITY MANAGEMENT DISTRICT

Draft Staff Report

Proposed Rules 2700 – General
2701 – SoCal Climate Solutions Exchange

October 2008

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EXECUTIVE SUMMARY

At the February 2008 Governing Board meeting, the Board approved development of the SoCal Climate Solutions Exchange, one of South Coast Air Quality Management District's (SCAQMD) Governing Board Chairman Dr. Burke's initiatives for 2008. The Board requested a two-step process. The first step was discussion of initial recommendations described in a White Paper, which was presented at the June 2008 meeting of the Governing Board. At that meeting, the Board provided direction to staff that rule development should proceed, which is the second step of the process. This staff report and proposed rules have been developed for the Board's consideration.

The objectives of the SoCal Climate Solutions Exchange are to provide high quality greenhouse gas emission reductions that enhance the local economy and capture needed co-benefits for Southern California as businesses achieve voluntary reductions of greenhouse gases. The proposed rules include mechanisms to recognize and quantify voluntary reductions, which would follow protocols that would be pre-approved by the SCAQMD Governing Board and have concurrence by CARB's Board or Executive Officer. A local program operated by SCAQMD can ensure that reductions are real, additional (surplus), quantifiable, verifiable, permanent over a specific time, and enforceable. This will be of value to facilities that need offsets for CEQA or other environmental mitigation, and may be of use for compliance with future AB 32 requirements or other programs.

Many greenhouse gas reduction strategies also have co-benefits of reducing toxic and criteria pollutants, which will further accelerate clean air objectives in Southern California. This can be especially beneficial in environmental justice areas when such strategies are implemented there.

The proposed rules include staff's initial recommendations for the rule language for the SoCal Climate Solutions Exchange. The SoCal Climate Solutions Exchange (Rule 2701) would allow generation of certified greenhouse gas emission reductions by parties other than the District. Projects would follow pre-approved project protocols that are approved as part of Rule 2701. Staff will develop Rule 2702 – Greenhouse Gas Reduction Program (Rule 2702) in the near future to enable SCAQMD staff to collect funds from parties that need certified emission reductions, pool those funds, and use them to reduce greenhouse gases.

The SoCal Climate Solutions Exchange would be a voluntary program where parties in the District could undertake projects to voluntarily reduce greenhouse gas emissions in advance of, or in the absence of, any regulatory requirement. These projects would follow pre-approved protocols as part of Rule 2701 that may have been developed by CARB, the California Climate Action Registry (CCAR), SCAQMD staff, other air districts, or other entities. It is staff's intention to work closely with these other parties to develop as many protocols as possible to encourage voluntary and early actions and to be able to have those reductions quantified. SCAQMD staff will submit all protocols to be used for the SoCal Climate Solutions Exchange for Governing Board approval via rule amendments (i.e., Rule 2701). Protocols will also have concurrence from CARB's Board or Executive Officer before

being presented to the Governing Board for consideration. Proposed Rule 2701 includes 3 project protocols that have been approved by CARB that staff recommends the Governing Board approve as part of the initial rule package. Other protocols are in development and would be approved by the Governing Board through future rule amendments.

Any certified reductions must be real, additional, quantifiable, verifiable, permanent over a specified time period, and enforceable. Having pre-approved protocols and SCAQMD staff verification and enforcement will address these criteria. Certified reductions will only be issued after SCAQMD verification.

Project proponents would be required to submit a plan registration with specific information on the planned project, including who the initial owner of the certified reductions would be.

The adopting resolution for these rules will include: direction to staff to seek concurrence from CARB on protocols for use in these rules; a statement clarifying that it is not staff's intent to require use of this program for California Environmental Quality Act (CEQA) mitigation; an evaluation of whether the program should be expanded to allow projects in other air districts if that district's staff served as the project verifier; and a statement that when a global warming potential is developed for carbon black, staff will seek to develop protocols that will reduce this pollutant, as well.

BACKGROUND

As climate change impacts are becoming better understood, more attention has been focused on reducing carbon dioxide and other greenhouse gases from actions by individuals, businesses, and levels of government ranging from cities to counties to nations.

There are many companies offering greenhouse gas offsets for sale, but there is uncertainty involved with many of the projects, and it is sometimes difficult to judge whether the offsets are real. In 2007, the Financial Times investigated many of the existing and emerging greenhouse gas offset markets, and concluded *“A Financial Times investigation has uncovered widespread failings in the new markets for greenhouse gases...The FT investigation found: widespread instances of...worthless credits that do not yield any reductions in carbon emissions...a shortage of verification, making it difficult for buyers to assess the true value of carbon credits...”*

In the last year, there are many examples where entities have purchased offsets to compensate for their carbon footprint. This is being done on an individual and company basis. Purchasing offsets can be voluntary or required, as part of the permitting process, as a result of a lawsuit, or in response to comments on CEQA documents or general plans. In many cases where a company cannot make adequate on-site changes to mitigate their carbon impacts, SCAQMD staff, and others throughout the state, are being asked what exchanges have credibility and how can someone ensure that the reductions they are purchasing are real?

The high degree of uncertainty that exists relative to greenhouse gas offsets is readily apparent. Recent newspaper articles continue to question whether certain offsets are real and

if the markets are producing desired results. In January 2008, the *New York Times* published an article titled “F.T.C. Asks if Carbon-Offset Money is Well Spent”. The Federal Trade Commission (FTC) is responsible for advertising claims, and held public hearings on green marketing, including carbon offsets. The article cited a heightened potential for deception and instances where assertions made about offsets were not substantiated. Also in January 2008, the California Attorney General asked the FTC to guard against fraud in the carbon offset market by sharpening guidelines. This was requested because the Attorney General’s staff felt that the offset market is volatile, largely unregulated, and has serious potential for fraud.

In May 2008, the *Stanford Daily* published an article that made the point that greenhouse gas credits may not actually reduce emissions. Research was cited that showed a substantial portion of offsets did not represent real emission reductions. In February 2008, three Wall Street banks announced that they would be working on setting standards to assess environmental risk related to carbon emissions.

In the CEQA arena, the California Attorney General challenged a CEQA document for a northern California refinery for failure to conclude whether greenhouse gas emissions from a project were significant and for failure to mitigate those emissions. That refinery is paying the Bay Area AQMD \$7 million to a carbon offset fund, which will be used to reduce greenhouse gases. A San Joaquin dairy expansion project also received comments from the California Attorney General regarding its CEQA document. The comments included a recommendation to consider additional on-site mitigation or purchasing offsets to mitigate increases in pollutants that contribute to climate change impacts.

The County of San Bernardino entered into a settlement agreement with the California Attorney General regarding greenhouse gas emissions in its General Plan. The settlement requires that the County develop an inventory and reduction plan for greenhouse gases. SCAQMD staff is assisting the County staff in its inventory development.

Recently, staff has analyzed, under CEQA, greenhouse gas emissions related to a Chevron project in the South Coast, and Chevron has agreed to pay the SCAQMD to mitigate greenhouse gas emissions that still result after on-site improvements. Many more projects are in the pipeline, and in the absence of CEQA thresholds, many project proponents will be required, or will choose, to obtain offsets as mitigation.

The staff at SCAQMD has decades of experience in issuing and certifying streams of emission reductions in the New Source Review (NSR) program, and also has developed and implemented rules for generation of mobile and area source short-term credits. Since 1994, SCAQMD staff has been implementing the Regional Clean Air Incentives Market (RECLAIM) which involves annual emission trading units and extensive tracking of trade activity. These experiences and lessons learned will help SCAQMD staff in the development and implementation of the SoCal Climate Solutions Exchange.

Background information is provided below to help set the context for why this initiative was introduced and how the SoCal Climate Solutions Exchange can become an important local program that will contribute to addressing a global problem, and help local businesses

needing greenhouse gas reductions. SCAQMD involvement will provide confidence to emission reduction generators and subsequent users.

Climate Change

Global warming results from an imbalance in the amount of solar radiation that is absorbed by the Earth or reflected back into the atmosphere. When particles or gases in the atmosphere cause more solar radiation to reflect back to Earth, increased temperatures occur.

In 1988, the World Meteorological Organization (WMO) and the United Nations Environment Programme (UNEP) established the Intergovernmental Panel on Climate Change (IPCC), a scientific intergovernmental body to analyze climate change impacts. The *IPCC Summary for Policymakers of the Synthesis Report of the IPCC Fourth Assessment Report, November 2007*, reports that the prevailing scientific view is that warming of the climate system is unequivocal. There are increases in global average air and ocean temperatures, widespread melting of snow and ice, and rising global average sea level. The IPCC also reports that global greenhouse gas emissions due to human activities have grown since pre-industrial times, with an increase of 70 percent between 1970 and 2004.

For California, impacts have been projected for a range of climate change scenarios in 2070 – 2099 in a California Energy Commission (CEC) report, *Our Changing Climate: Assessing the Risks to California (2006)*. Business-as-usual is projected to result in 8 to 10.5 degrees Fahrenheit increase, with 90 percent loss of Sierra snow pack, 22-30 inches sea level rise and 3-4 times the number of heat wave days. Even with the Governor's aggressive target of lowering California's greenhouse gas emissions to 80 percent below 1990 levels by the year 2050, projected increases of 3-5.5 degrees Fahrenheit are expected to reduce Sierra snow pack levels by 30-60 percent, bring about 6-14 inches of sea level rise, and result in 2-2.5 times the number of heat wave days.

Additional climate change impacts include health problems resulting from exacerbation of air pollution due to increased temperatures which leads to increased ozone and particulate formation, and increased infectious diseases. Water-related issues include more droughts and flash floods, and a decrease in potable water supply and quality. Decreases in food supply, increases in wildfires, and decreases in forest productivity are also expected to occur.

Climate change is a global problem, one that will require actions at all levels of government and through other avenues (such as changes in consumer and personal choices) to resolve.

Voluntary Carbon Markets

There are voluntary carbon markets in the U.S. that have been, or are being, developed in response to efforts to reduce greenhouse gases. Voluntary markets allow individuals, businesses, and organizations to offset their carbon footprint through a variety of projects world wide.

The Chicago Climate Exchange (CCX) started in 2003 and has over 300 members. Members make a commitment to reducing greenhouse gases and are given allocations with a declining balance. Selling excess allocations or purchasing allocations to match emissions with the annual allocation are part of this cap-and-trade program. Qualifying offset projects can also

generate reductions which are traded on the CCX. Such offsets can be produced world-wide, which makes verification more challenging.

There will be more exchanges developing as climate change regulations become more prevalent in the U.S. In California, the CCAR is developing a registration and trading program for voluntary early reductions under AB 32, focusing on offsite reductions from sources that are less likely to be regulated. In 2006, CCX announced the formation of the New York Climate Exchange and the Northeast Climate Exchange, who will develop instruments for Regional Greenhouse Gas Initiative (RGGI) in 2009.

RGGI is an agreement that is signed by the Governors of 10 member states, including: Connecticut, Delaware, Maine, Maryland, Massachusetts, New Hampshire, New Jersey, New York, Rhode Island, and Vermont. The states agree to cap emissions from fossil-fuel fired electric generation plants larger than 25 MW at current levels for 2009. A cap-and-trade program is in place with a 10 percent decrease in greenhouse gas emissions from program participants by 2019.

LEGAL AUTHORITY

The SCAQMD obtains authority to adopt, amend, or repeal rules and regulations from Health and Safety Code Sections 39002, 40000, 40001, and 40725-40728.

PUBLIC PROCESS

The Governing Board established a Climate Change Committee, which met on March 20, 2008, May 28, 2008, August 13, 2008, and September 19, 2008 to work with staff on this initiative. In addition, climate change was extensively discussed at the Governing Board's April 17, 2008 retreat.

Staff has been working with a Technical Advisory Group comprised of representatives from CARB, CCAR, environmental and community groups, industry, academic institutions, and local government. This group has helped brainstorm initial concepts and provided valuable insight and perspectives on key design elements. The input from this group has influenced staff's recommendations/concepts, which are reflected in this staff report. This group has met five times, on March 19, 2008, April 2, 2008, April 23, 2008, May 22, 2008 and October 2, 2008. The meetings were open to the public, and other attendees also provided beneficial input.

CARB staff has indicated that the SoCal Climate Solutions Exchange could help stimulate voluntary early reductions, which they strongly encourage. Staffs from SCAQMD, CARB and CCAR have all committed to work together on protocol development for the SoCal Climate Solutions Exchange.

In addition, other air districts in California, through the California Air Pollution Control Officers Association (CAPCOA), have participated in an initial discussion with CARB and

CCAR regarding how to best coordinate drafting protocols. CAPCOA, CARB and CCAR staffs evaluated the protocols that are planned for development, added suggestions for others that would be beneficial and determined which air district or agency is best suited for developing specific protocols. This will maximize resources and avoid potential duplicative efforts. Protocols will need input by the other agencies, as well as the public, and are intended to be approved for use by SCAQMD, other air districts, CARB and CCAR. A larger selection of approved protocols will be helpful for facilities and for each of these agencies. As additional suggestions are made for other protocols, CARB, CCAR, and CAPCOA or SCAQMD will determine which agency or district should evaluate the proposal for potential protocol development.

SoCAL CLIMATE SOLUTIONS EXCHANGE

The SoCal Climate Solutions Exchange is envisioned to help stimulate voluntary early actions for reducing greenhouse gases. Greenhouse gas emission reductions that rigorously follow approved protocols and are monitored and certified by SCAQMD staff will provide confidence that emission reductions are real and will continue to be maintained over the life of the project. This will provide a valuable service for facilities needing CEQA mitigation now, and the certified reductions may have possible use with future AB 32 compliance. This will depend on regulations that CARB will develop.

The objective of the SoCal Climate Solutions Exchange is to provide high quality greenhouse gas emission reductions that enhance the local economy and capture needed co-benefits for Southern California. Certified greenhouse gas emission reductions can be beneficial for businesses or others that achieve voluntary, early reduction of greenhouse gases. The development of the protocols for quantification, and rules and procedures for certification of emission reductions, registration, tracking of the certified emission reductions will ensure that any reductions in this program will meet the key criteria for any program of this nature:

- Real – the reductions actually occur;
- Additional – the reductions are not required by any regulation or would not have happened anyway;
- Quantifiable – the reductions can be measured using tools or tests that are reliable and give confidence;
- Verifiable – the action that resulted in reductions can be audited and there is sufficient evidence to show that the reduction occurred and was quantified correctly;
- Permanent – the reduction will be real and additional over a specified time period; and
- Enforceable – there is an enforceable mechanism in place to ensure that the action is implemented correctly, such as a contractual agreement with specific conditions and terms.

Any reductions must follow approved project protocols so the quantification is of sufficient quality to ensure that the reductions are real, quantifiable, and verifiable. Certified reductions must also be additional. Additional is generally compared to regulatory requirements and

common practices. The basic concept for “additionality” is that the reductions would not happen anyway. Additional is sometimes compared to a regulatory deadline. Reductions that occur at least a specific amount of time before the required date can be considered additional. The protocols that are proposed for inclusion in Proposed Rule 2701 do not have a regulatory deadline that would be a factor. Some of the protocols under development, such as truck stop electrification, may have future regulations affecting that category. Truck stop electrification is one of the AB 32 early action measures which is scheduled for initiation of rule development by 2012. That would need to be addressed in this protocol relative to when actions would be additional to the rule requirements.

Another important criterion is that any reductions be verifiable. SCAQMD staff would review projects, determine if the project properly followed the appropriate protocol, and the project was executed correctly. The certified reductions must be permanent, over a specified life time which relates to the additionality of the reductions. Any reductions must also be enforceable, through permit conditions, enforceable plans, or other mechanisms to help ensure the validity of the reduction.

The SoCal Climate Solutions Exchange is envisioned to facilitate local investments. Local businesses and other parties will have certainty that reductions will be of high quality, although the future need or use for these credits is yet to be determined by regulatory agencies authorizing or allowing such use. Short term needs, before CARB develops the regulatory structure and measures to implement AB 32, include the use of such certified reductions as offsets for CEQA or other mitigation.

Many greenhouse gas reduction strategies also have co-benefits of reductions of criteria or toxic pollutants. These can be especially helpful in environmental justice areas. Promoting voluntary, and early, reduction projects in the District can help accelerate other important clean air objectives.

DESIGN PRINCIPLES

The following design principles were used in development of the SoCal Climate Solutions Exchange:

- 1. Program development will occur in an open public process.*
- 2. Reductions will be real, quantifiable, verifiable, additional, enforceable, and permanent over a specified time period.*
- 3. Incentives will be available to encourage reductions in environmental justice areas.*
- 4. Program administration will be efficient, streamlined, timely, and without conflicts of interest.*
- 5. Fees associated with the SoCal Climate Solutions Exchange will enable the program to be self-sustaining.*
- 6. Information for the public and participants in the SoCal Climate Solutions Exchange will be transparent.*

SUMMARY OF PROPOSED RULES

The following is a summary of the Proposed Rules 2700 & 2701.

Proposed Rule 2700 – General

Rule 2700 specifies various definitions used for rules under Regulation XXVII. The definitions specified under the proposed rule support Rule 2701 at this time and include: additional, carbon dioxide equivalent, certified greenhouse gas emission reduction, global warming potential, greenhouse gas, protocol, and SoCal Climate Solutions Exchange. There is a table that lists global warming potentials that would be used to calculate carbon dioxide equivalents (CO₂E).

Greenhouse gases, for this Regulation, include carbon dioxide (CO₂), methane (CH₄), nitrous oxide (N₂O), sulfur hexafluoride (SF₆), hydrofluorocarbons (HFCs), and perfluorocarbons (PFCs).

One of the most important definitions is “additional.” The definition of “additional” for the draft rules is “the greenhouse gas emission reduction achieved throughout the duration of the activity is (a) not occurring due to routine equipment replacement, or (b) is not otherwise required or would occur as a result of any local, state, or federal regulation, or any legal instrument, to ensure no double counting or inappropriate granting of reductions. The specific requirements for a reduction to be considered additional will be part of the quantification protocol for the specific project types.”

The definition of additional in Rule 2700 does not include financial additionality, which is an element that is often used in offset programs, such as the Clean Development Mechanism (CDM) and Joint Implementation (JI) which are used in Europe. Each project undergoes an evaluation and it must be determined that the project would not go forward without the increased income from selling the resultant offsets. For the protocols that staff envisions for use in Rule 2701, each category will be evaluated, rather than a case-by-case review of each project. This will streamline the process for certified greenhouse gas emission reductions and decrease the cost and administrative burden.

The protocols for approval at this time do not include a timeline before a regulatory due date, as this is not applicable for these categories. Should it become an issue in the future, it will be addressed through each protocol and consistent with CARB’s determination.

It is not the intent of this rule to exclude reduction generation opportunities from counties subject to local government ordinances or agency policies designed to achieve voluntary greenhouse gas reductions. However, explicit authorization needs to be expressed by the responsible agency in order to qualify for certified emission reductions.

Rule 2700 includes a table of global warming potentials, based on information in the Intergovernmental Panel on Climate Change (IPCC) Second Assessment Report, 1996. This information is consistent with CARB’s greenhouse gas inventory for the state. Having global warming potential conversion factors enables a comparison of different gases and a standard

way to estimate the climate change impacts. A 100-year time horizon is used, and global warming potential is related to the impact of one unit of carbon dioxide, which is given a factor of 1. Other gases range from 21 to over 23,000 times the global warming potential of carbon dioxide. Not all substances that contribute to global warming have a global warming potential assigned. For example, carbon black, which is emitted from combustion of diesel fuel and coal, is known to have warming effects. It has a lifetime of weeks, rather than decades or longer, and there is uncertainty regarding the climate forcing aspects. As scientific information improves, a global warming potential may be assigned.

Proposed Rule 2701 – SoCal Climate Solutions Exchange

The purpose of this rule is to establish a voluntary program to encourage, quantify, and certify voluntary, high quality greenhouse gas reductions in the District. The rule applies to projects in the District that follow pre-approved quantification protocols regardless of whether the project involves equipment or a facility that is required to have a District permit.

Staff originally proposed that projects in other parts of California also be allowed provided the project follows a pre-approved protocol and there is an agreement between SCAQMD and another local air district that their staff will act as verifiers. Since the intent is to maximize co-benefits in the District, this provision has been removed. The adopting resolution will include a commitment to evaluate this option in the future.

Any person may purchase certified emission reductions created pursuant to the regulations. There are no restrictions from the District regarding use of certified reductions generated pursuant to an approved protocol.

The proposed rule specifies requirements for the generation, issuance, and use of certified greenhouse gas emission reductions. It also includes elements for registration and tracking of reductions, public information, an annual report, and implementation guidelines. These are briefly described below.

Generation of Certified Greenhouse Gas Emission Reductions

Reductions could be generated by any person, following a protocol that has been pre-approved by the Governing Board. A Plan would be submitted with specific information on the project, including the protocol that will be followed, the nature of the reductions (such as the greenhouse gases involved and the projected amount of reductions), the funding source, the date that the reductions are projected to start occurring, the location of the project or activity, the length of time the project or activity is anticipated to continue, the responsible person, and the initial owner of the certified emission reductions once reductions have been verified and certified by SCAQMD staff. The person doing the project would notify the District and submit information required under the applicable protocol each year, if required, so reductions can be quantified. Records would be kept for at least five years and be available to SCAQMD upon request.

Issuance of Certified Greenhouse Gas Emission Reductions

Staff will evaluate complete Plan submittals within 60 days, unless an extension is mutually agreed upon. Certified emission reductions will also be issued in a timely manner (within 90 days) of receiving complete information after reductions are achieved. Emission reduction certificates will be issued to the nearest metric ton and be given a unique tracking number. For greenhouse gases, the convention is to deal with metric units. A metric ton is 2,204.6 pounds. Ownership will be issued to the person or agency funding the reductions, unless the District receives authorization to issue certificates to another person.

Any co-benefits that result from implementing projects to reduce greenhouse gases under this rule will not be issued to the project proponents, unless the specific greenhouse gas protocol includes a mechanism to quantify the reductions and enables the project proponent to obtain reductions other than greenhouse gases (i.e., criteria pollutants). This is to avoid double counting since the 2007 SIP relies on a certain portion of co-benefits to meet the SIP obligation (i.e., 3 tons per day for NO_x reductions by 2014). If public funding is involved in a project, the agency providing the funding can specify if the reductions or any portion of the reductions should have ownership designated to another entity.

Use of Certified Emission Reductions

It is envisioned that certified greenhouse gas emission reductions generated pursuant to Proposed Rule 2701 could be beneficial for use in CEQA or other mitigations, retirement to reduce a carbon footprint (by an individual, household, facility, corporation, community, city, or other group), or other uses, if authorized. For example, if a California, Western Climate Initiative or national program includes offsets in a future cap-and-trade program for greenhouse gases, certified emission reductions from this proposed rule may be useful for those programs.

Registration of Certified Emission Reductions

Once certified greenhouse gas emission reductions are issued, SCAQMD will list them on the District web site, which will be public information. Certified emission reductions could be listed on other sites or exchanges. Certificates, once issued, will not be transferable unless the transfer is recorded by SCAQMD. The web site will be updated quickly to keep the information as current as possible.

Public Information and Program Annual Report

Rule amendment proceedings will be used for pre-approval of protocols to help ensure a good public process. Staff plans to bring protocols to the Governing Board from a variety of sources, including SCAQMD and other air districts, CARB, CCAR and other entities. Staff will seek CARB concurrence on protocols before bringing them to the Board for approval. This can occur either through a CARB Board adoption or their Executive Officer, as allowed through CARB's policy on voluntary early actions (February 2008.)

Information on projects and the use of certified emission reductions will be public information. The District web site will be maintained to list what certified greenhouse gas reductions have occurred and are available for sale. Information will be provided as to the type of projects, location, emission reductions, and contact information.

An annual report will go to the Board each year to summarize what protocols have been adopted and used, the types and locations of projects, and the greenhouse gases and other pollutants reduced.

Staff will recommend in the adopting resolution for these rules that third-party audits be conducted on program implementation.

Implementation Guidelines

Implementation guidelines will be developed to address implementation issues related to Rule 2701, including reduction verification procedures, field inspections, etc. Staff will bring the initial guidelines and any substantive revisions to the Board for approval to ensure a transparent public process. The Implementation Guidelines can include the verification procedures that staff will follow, and other areas where implementation issues need to be documented or clarified. Substantive revisions will not include corrections of typographical errors or addition or change to information that would not change the emission quantification results.

Appeals

Industry requested that the proposed rules include an appeals process in the event that a project was denied or the project proponent did not agree with the amount of certified greenhouse gas emission reductions that were issued. The proposed rule includes such an appeal to the Hearing Board.

Protocols

Rule 2701 also includes a list of project protocols for use in this regulation. Protocols generally fall into two types – project protocols where specific actions can result in “additional” quantified reductions, and entity protocols which deal with how to quantify greenhouse gas emissions at a facility (or other broader application). For the purpose of this Regulation, protocols refer to a project protocol, rather than a facility or entity. Currently, there are 3 project protocols that have been developed by CCAR and approved by the CARB Board. These include forest and urban forest projects, and manure management, which is installation of digesters for dairies. CAPCOA members and District staff are developing other protocols which can be brought to the Board as rule amendments. At this time, District staff is working on protocols for the following project categories, and will develop each protocol in collaboration CARB, and have a public workshop before Governing Board consideration:

- boiler efficiency;
- truck stop electrification;
- lawn mowers;
- leaf blowers; and
- replacement of refrigerants.

FEES

This section of the staff report summarizes the different fees that would be associated with this regulation. The intent is to have fees support the implementation of the program and be reasonable for the program participants.

For Rule 2701, generators would pay Plan Fees based on Rule 306 – Plan Fees. The following information is from the May 2008 version of the rule. Currently, fees would include an initial filing fee of \$112.30, and evaluation fees of \$112.30 per hour, per Rule 306 subdivisions (c) and (d), respectively. An initial payment of \$393.05 is required (subdivision (i)). Other applicable fees could include inspection fees of \$89.80 per hour, optional expedited processing, if requested, at 50 percent increase over the applicable fees, and annual renewal fees of \$293.21, if applicable, per subdivision (h). Small business fees could also be applied pursuant to Rule 306 subdivision (g). A 50 percent discount is available for fees in subdivisions (c), (d), (f), and (g). Cancellations would be subject to the fees in subdivision (\$149.70).

Registration and transfer of certified greenhouse gas emission reductions would be subject to a fee of \$134.10. This is consistent with the fees that are currently charged for RECLAIM transactions.

Rule 2701 fees would be evaluated periodically and revisions would go to the Board in a public hearing.

CALIFORNIA ENVIRONMENTAL QUALITY ACT

The SCAQMD has reviewed the proposed project pursuant to the CEQA Guidelines §15002 (k)(1), the first step of a three-step process for deciding which document to prepare for a project subject to CEQA. Proposed Rule 2700 establishes definitions and includes a table of global warming potentials. Proposed Rule 2701 establishes the SoCal Climate Solutions Exchange, which is a voluntary program that quantifies and certifies real GHG emission reductions taking place in California. Proposed Rule 2701 provides a mechanism for the SCAQMD to verify voluntary GHG reduction projects. Once verified, proposed Rule 2701 allows the Executive Officer to issue certified GHG emission reductions using protocols identified in proposed Rule 2701. Both proposed Rules 2700 and 2701 are administrative in nature because the SCAQMD is not involved with funding or generating GHG emission reductions and the rules do not cause any generation of credits. The protocols included in the rule can already be used to generate reductions. The proposed rules will not cause any change to the physical environment. Therefore, it can be seen with certainty that the proposed project has no potential to adversely impact air quality or any other environmental area and, as a result, it is exempt from CEQA pursuant to state CEQA Guidelines §15061(b)(3) – Review for Exemption. The Notice of Exemption will be filed with the county clerks of Los Angeles, Orange, Riverside and San Bernardino counties immediately following the adoption of the proposed project.

SOCIOECONOMIC ASSESSMENT

Proposed Rules 2700 and 2701 represent a voluntary program. Businesses and individuals will not participate in the proposed program if there is no perceived benefit. As such, no negative socioeconomic impacts are expected. Since the rules do not significantly affect air quality or emissions limitations, the law does not require a socioeconomic assessment.

DRAFT FINDINGS

Health and Safety Code Section 40727 requires the SCAQMD to adopt written findings of necessity, authority, clarity, consistency, non-duplication and reference.

Necessity

A need exists to adopt Proposed Rules 2700 and 2701 to incentivize the early reduction of greenhouse gases to assist in achieving additional (surplus) early emission reductions by providing a transparent public process, as well as a consistent mechanism to generate reductions that are real, additional, quantifiable, verifiable, permanent and enforceable.

Authority

The SCAQMD Governing Board obtains its authority to adopt, amend, or repeal rules and regulations from California Health & Safety Code Sections 40000, 40001, 40702, and 40725 through 40728, inclusive.

Clarity

The proposed rules have been written or displayed so that their meaning can be easily understood by persons directly affected by them.

Consistency

The proposed rules are in harmony with and not in conflict with or contrary to, existing statutes, court decisions or state or federal regulations.

Non-Duplication

The proposed rules do not impose the same requirements as any state or federal regulations. The adoption is necessary and proper to execute the powers and duties granted to SCAQMD.

Reference

By adopting the proposed rules, the SCAQMD Governing Board will be implementing, interpreting, and making specific the provisions of the California Health & Safety Code 40000 (District's primary authority to regulate air pollutants from non-vehicular sources) Section 40001 (rules to achieve ambient air quality standards) and 38562 (CARB rules including market-based rules to reduce greenhouse gases.)

AQMP/LEGAL MANDATES

The proposed rules are not the result of a control measure of the 2007 AQMP and there are no legal mandates to implement the program; however, the proposed rules are intended to create a mechanism to quantify high quality additional (surplus) reductions of greenhouse gases, per the Governing Board's direction.

REFERENCES

SoCal Climate Solutions Exchange White Paper, South Coast Air Quality Management District, June 2008.

RESPONSE TO COMMENTS

A public workshop was held in Diamond Bar on September 4, 2008. Approximately 20 people attended. The following text summarizes comments and staff responses to the key comments raised at the meeting, as well as written comments (3) received by September 29, 2008.

General Comments

1. Comment: The Legislature gave ARB, with input from the CPUC and the CEC, the directive to develop a program to address GHG emissions from stationary sources. It is now deeply engaged in this effort. We believe that a SoCal Climate Solutions Exchange could lead to a fragmentation of California's global warming control effort. For example, the whole issue with "additionality" or "surplus" gets very challenging if multiple agencies are defining these terms in a different manner.

Response: Staff, in its comments to CARB on the Scoping Plan, requested that CARB define "additional." Since CARB would be reviewing the protocols, and protocols will not be added to Rule 2701 without CARB's concurrence, there should not be any inconsistencies when determining additionality for this program. In addition, Regulation XXVII is completely voluntary as to reduction generation and use; therefore, it is unlikely that SCAQMD's program would lead to a fragmentation of the state's climate change effort.

2. Comment: There is no need for a new credit program at the local level. If a facility wishes to get credit for reductions it generates at a facility, it can already do so through CCAR and soon, through the ARB. The credits issued by these organizations would be highly fungible and verifiable.

Response: This will be a voluntary program, so project proponents can choose what program to be involved with. The staff's intent is to use consistent protocols as CARB, and to have concurrence by either the CARB Board or Executive Officer. CCAR may wish to approve protocols developed by or for the SCAQMD, as well. The purpose of

SCAQMD's Exchange program is to provide an additional option for local entities to generate high quality greenhouse gas reductions and for any user who prefers local reductions.

3. Comment: The program has insufficient checks and balances. As we understand the proposal, the District would be the responsible party for all aspects of the trading program – credit generation, credit issuance, verification, establishing price, credit registration and brokering the credits, as well. We know of no other system where one entity has control over all aspects of such a program. The current practice of disaggregating these responsibilities, especially the verifying and brokering aspects, to parties with well-developed skills in each area has worked well in a wide variety of trading markets. The lack of third-party oversight, checks and balances, and the insular nature in this proposal could unnecessarily undermine the integrity of the system, its participants, the products traded, and quite possibly the core mission of the SCAQMD to attain federal and state air standards.

Response: The District has implemented many programs involving credit generation and issuance, and has had many roles in these programs. The following table illustrates many of these examples, and the actions that District staff has been involved in. For example, the RECLAIM AQIP had the same roles for the District as what is proposed for the SoCal Climate Solutions Exchange.

SCAQMD Credit Programs

	Receive \$	Generate Reductions	Verify	Issue	Register	Track Trades
ERCs	N	N	Y	Y	Y	Y
Moyer	Y	Y	Y	n/a	n/a	n/a
1309.1	Y	Y	Y	n/a	n/a	n/a
RTCs	N	N	Y	Y	Y	Y
2202 AQIP Private	N	N	Y	Y	Y	Y
2202 AQIP SCAQMD	Y	Y	Y	n/a	n/a	n/a
RECLAIM AQIP/ Mitigation Fee	Y	Y	Y	Y	Y	Y
Mobile & Area Source Credits	N	N	Y	Y	Y	Y
SoCal Climate Exchange Reductions	N	N	Y	Y	Y	Y

The following table illustrates the roles involved in different exchanges. With the exception of verification, the proposed SoCal Climate Solutions Exchange is not different from major exchanges, such as CCX or ECX.

<u>ROLE</u>	SoCal Climate Solutions Exchange	CCAR	CCX	ECX
Protocol Development	✓	✓	✓	✓
Verify	✓	no	no	no

Register	✓	✓	✓	✓
Track Trades	✓	✓	✓	✓
Run Market	?	no	✓	✓

Rules 2700 and 2701 do not include the District generating reductions or establishing price, although these may be part of a future Rule 2702 – Greenhouse Gas Reduction Program. Staff does not agree that implementing this program will affect its core mission. In fact, when properly designed, Rule 2702 may generate co-benefits in criteria pollutants and air toxic reductions that facilitates meeting the District’s core mission. The adopting resolution for Rules 2700 and 2701 will include periodic independent audits. The program will be implemented transparently, with public information available on the web and a comprehensive annual report.

4. Comment: There are too many roles for the District in this program. It would be appropriate for the District to approve project applications or to verify their performance, but not both.

Response: Under Rule 2701, District staff only serves as a verifier, while Rule 2702, which will be introduced later, requires the District’s Governing Board to approve the project selection and the staff to verify reductions. District staff have extensive experience in many credit generation and offset type programs, including mobile and area source credits, projects under Carl Moyer, RECLAIM mitigation fee program, rideshare offsets, and others. In many of these programs, staff has done multiple roles, including both project selection, and review of reductions. We have staff knowledgeable of the sources that will be involved with the protocols and have the experience to do this effectively. To help address the concern raised, staff is recommending periodic program audits and a transparent process.

5. Comment: The definition of Control Strategy Proposal suggests that the District will develop proposals to control greenhouse gas emissions. There are no regulations empowering the District to regulate greenhouse gases.

Response: This definition was removed from the rule, as the terminology was changed. To clarify its original intent, the Control Strategy Proposal refers to proposals in response to the District’s solicitation to generate certified reductions. It is not associated with any mandatory requirements.

6. Comment: For projects undertaken for Rule 2701, can a third-party or CARB staff serve as the verifier?

Response: As currently proposed, the intent is to have SCAQMD providing the verification function. The adoption resolution will direct staff to consider expanding the program to include projects located outside of the District, but in state. During such time, SCAQMD may consider using district personnel from other air districts, as verifiers through agency agreements.

7. Comment: We encourage staff to include language that would provide an appeals process for the applicant applying for credits. We expect the use of such process to be a rare event, but we believe it is important to have a process established up front should it become necessary.

Response: Staff is not aware of such a process in other credit generation programs. Having standard protocols and Implementation Guidelines will standardize this process and should minimize any potential conflicts. However, staff is including language regarding appeals in Rule 2701 to address the concern.

8. Comment: SCAQMD will be taking on significant liabilities associated with operating or contracting out the operation, of a central counter-party clearing Exchange (similar to CCX or CME). These risks include counter-party credit risk, collecting and maintaining performance bonds and margins, and negotiating all trade settlement contracts.

Response: Staff is evaluating this as part of Rule 2702 development.

9. Comment: SCAQMD staff is considering resolution language to accompany the proposal that would clearly indicate that GHG CEQA mitigation could be achieved through a variety of means, this being only one option. Such language would be very beneficial.

Response: Comment noted.

Protocols

10. Comment: SCAQMD should not restrict the definition of approved protocols. Other qualified organizations, such as EPA, The Climate Registry, the Western Climate Initiative, and many international agencies and groups have developed protocols that should be available for use in this program. The District would have to validate protocols for hundreds of sources, which is infeasible. Adding protocols to the rule will result in delays.

11. Response: Staff wants to be as inclusive as possible, consistent with the reliability of the protocols and intends to develop a robust list of protocols for use in this program. The list of protocols in the rule could include protocols developed by any organization, provided they would result in additional reductions in the District. Protocols need to be prioritized based on the likely use in the Basin, emission reduction, ability to verify reductions, and cost effectiveness. By adding the protocols specifically in Rule 2701, this ensures a public process. There will be some delay in this process, but staff will try to keep this to a minimum.

12. Comment: Without District approval of a specific protocol, a source or project may be unable to achieve a prescribed permit requirement or comply with a regulatory target.

Response: The protocols for these rules would be developed for specific projects that are additional to any regulatory requirements. The protocols would not be relevant to achieving a specific direct regulation or complying with a regulatory target.

13. Comment: Project co-benefits of toxics or criteria pollutants should accrue, at least in part, to the project proponent.

Response: There are currently no credit programs for toxics (and no trading of toxics) and limited opportunities for creation of short term criteria pollutant credits. The 3 project protocols that are proposed to be included initially for this regulation do not address this issue. As future project protocols are developed, staff will evaluate any concurrent toxic or criteria co-benefits. The underlying protocol would need to specifically authorize any accrual of co-benefits to the project proponent, and other rules might need to be adjusted to allow their use. In addition, the 2007 AQMP assumed some reductions of criteria pollutants as a result of greenhouse gas control measures. In order to qualify as additional, or surplus, the individual measure would need to be evaluated to determine if criteria pollutant reductions were already assumed.

14. Comment: Greenhouse gas reductions resulting from compliance with criteria pollutant rules should be counted toward any greenhouse gas reduction requirements.

Response: Greenhouse gas reductions that are a direct result of actions taken to comply with other regulatory requirements, such as criteria pollutant rules, need to be carefully evaluated to determine if the greenhouse gas reductions could be additional. As District staff adopts or amends criteria pollutant rules in the future, an evaluation will be done regarding reductions, co-benefits, and cost-effectiveness. For example, if a NO_x rule would not be cost-effective based on the NO_x reductions alone, but the rule would be cost-effective when additional greenhouse gas benefits are quantified, that rule may go to the Board with a recommendation to adopt the rule and develop a protocol for quantifying and certifying the greenhouse gas reductions.

As CARB defines direct measures and the cap-and-trade system for large industrial sources, this suggestion should also be considered in that context. Those program rules will need to define how greenhouse gases reductions that result from rule requirements for criteria pollutants would be considered towards satisfying a declining facility-wide greenhouse gas cap.

15. Comment: Staff should clarify that these protocols are ‘project’ protocols to distinguish them from ‘entity’, or facility-based quantification protocols.

Response: This suggestion has been incorporated in the Staff Report.

16. Comment: There should be consistency between protocols that are approved by CARB and those in Rule 2701. There should be no delay between these two approvals.

Response: SCAQMD staff will closely follow the development of protocols and will

bring protocols approved by CARB to the SCAQMD Governing Board as quickly as possible. Staff did not want to automatically approve such protocols without giving the public the opportunity to have input, which will be provided by taking Rule 2701 through the amendment process to add protocols.

Interaction with Other Programs

17. Comment: CARB has a policy to encourage early, voluntary greenhouse gas reductions, although the process for how this will be implemented is not yet defined. SCAQMD staff should work with CARB staff in a formal process to give more certainty regarding what actions would be additional, and qualify for the SoCal Climate Solutions Exchange.

Response: Staff from the two agencies are working together on development of protocols and on the concepts for this regulation. For Regulation XXVII, the protocols will be approved by both the SCAQMD Governing Board and will have concurrence by the Executive Officer or CARB Board. SCAQMD staff agrees that it would be beneficial for CARB to provide guidance in the Scoping Plan on what reductions would be considered additional.

18. Comment: Can reductions generated under Rule 2701 be sold under different markets or will they have to be sold through an SCAQMD exchange?

Response: Reductions could be listed on any exchange that allowed them.